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IN THE

Supreme Court of the United States

October Term, 1971
No. 71-1037

MITZI LEE REDKE,

Respondent,

vs.

ABRAHAM SILVERTRUST and JOHN ERVIN, as Executors of the Estate of Samuel Hayden, Deceased; ABRAHAM SILVERTRUST and RUTH K. ALLENDER HAYDEN, as Co-Trustees of the Amended Samuel Hayden Trust No. 1; RUTH K. ALLENDER HAYDEN; ABRAHAM SILVERTRUST and BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION, as Testamentary Co-Trustees under the Will of Ann Gollos Hayden, Deceased,

Petitioners.

PETITIONERS' REPLY BRIEF.

ALLAN BROWNE,
9171 Wilshire Boulevard,
Beverly Hills, Calif. 90210,
(213) 273-6333,
Attorney for Petitioners.

HERMAN F. SELVIN,
450 North Roxbury Drive,
Beverly Hills, Calif. 90210,
(213) 274-8011,
Attorney for Petitioners.

Parker & Son, Inc., Law Printers, Los Angeles. Phone 724-6622

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PETITIONERS' REPLY BRIEF.

I.

The Intent of the Parties in Failing to Disclose the Oral Agreement Is Entirely Immaterial in the Case at Bar.

Respondent misconceives the thrust of the petition for writ of certiorari.

The bulk of respondent's brief is devoted to arguing the good faith of Ann and the bad faith of Samuel in failing to reveal the existence of the oral agreement. This argument is totally immaterial. Petitioners respectfully submit that the cases cited in the petition for writ of certiorari (pp. 18-20) demonstrate that an agreement may not be enforced if it tends to promote unlawful acts, *regardless of the intent of the parties in making the agreement.* An agreement which encourages

tax evasion on the part of others clearly is against public policy and unenforceable.

Whether or not Ann or Samuel intended to defraud the federal government of taxes due, the undisputed fact is that both parties consulted with their legal and tax advisors *after* making the oral agreement and failed to disclose it. *After making the oral agreement* Ann expressly reaffirmed *in writing* the provisions for the *marital deduction*, although that tax benefit was not lawfully obtainable. [Ex. 33].

Considering the prodigious estate planning of both parties over the years, the consultations with their attorney and accountant concerning the marital deduction, the written changes to their estate plans *after making the oral agreement*, and Ann's *written* reaffirmation of the marital deduction in March, 1963, the failure to disclose the agreement is inexcusable—without speculating on the parties' intent or state of mind. Their conduct, if condoned, will invite and promote a pattern of similar conduct by others which eventually will whittle away any vestige of respect for the requirements of the marital deduction. To sanction such an arrangement will result in a sharp curtailment in tax revenues to the federal government in years to come.

The issues in this case transcend that of defeating the requirements for the marital deduction. Enforcement of this oral agreement will invite evasion in other areas of taxation where a secret agreement can be made to circumvent legislative requirements for deduc-

tions and credits applicable to the income and estate and gift tax law. Taxpayers will be permitted to reap unlawful tax benefits and enforce the undisclosed side agreement simply by pleading innocence and good faith. The probability is that an undisclosed oral agreement will never be discovered thereby permitting the parties to take the unlawful tax benefit, attain their desired objective by performance of the undisclosed side agreement, and illegally circumvent the tax law with little risk of punishment.

The decision of the Court of Appeal (vacated by the California Supreme Court) is based upon sound reasoning and serious concern for the administration and enforcement of our tax laws. The Court of Appeal stated:

> "Appellants' argument which we feel has merit is that to enforce the agreement is to sanction an arrangement for the disposition of property in circumvention of Federal and State tax law. If Samuel was bound by the oral agreement to give the property in question to Mitzi, then he did not have an unlimited power of appointment and thus the marital tax deduction was not proper.
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> * * *
>
> "The freedom of individuals to contract enjoys a highly protected status in our law. It is, elementary contract law, however, that our courts will not lend their aid to enforcement of contracts which are illegal and contrary to public policy.
>
> "The illegality, and hence unenforceability of a contract, may be found in the consideration, the promise or the performance.

"These rules are more easily stated than they are applied to a given set of facts. The term 'public policy' itself defies precise definition.

"Contracts which have been declared by our courts to be unenforceable run the gamut from those where parties undertake to breach a criminal statute to those which, though legal and innocent on their face, result by their performance in illegality or contravention of public policy.

"At the risk of oversimplification we think it safe to say that the granting or withholding of judicial aid in the enforcement of contracts depends in large measure on the gravity of the offense to public policy and the equitable posture of the person seeking the enforcement. Mitzi who now stands in the shoes of Ann must succeed or fail according to the application of these considerations to Ann's conduct.

"Evasion of taxes is an extremely serious matter, for which severe criminal penalties can attach. In addition, the public has a strong interest in the integrity of the application of its tax laws. Thus where '[t]he effect of [the] agreement would be to deprive . . . the State of California and the United States government of taxes properly due . . . the agreement [is] void as against public policy. . . .' (*Kopasz v. Wymer*, 118 Cal. App.2d 119, at p. 121.)

"Respondent argues that the oral agreement itself was perfectly legal and could have been performed without any fraud or evasion of taxes. The ultimate fact is that it was not so performed and it is inescapable that it was Ann who knowingly

equipped Samuel with the means by which it was performed.

"In any event, 'If the effect of the agreement is to accomplish an unlawful purpose, however, the agreement will be declared illegal regardless of the intention of the parties. Indeed, the mere tendency of an agreement to promote unlawful acts may render it illegal as against the policy of the law. [Citation.]' (*Stockton Morris Etc. Co. v. Calif. Etc. Corp.*, 112 Cal.App.2d 684, 690.)

"If this judgment is allowed to stand, the taxing authorities will probably be able to recoup whatever might be owing in light of the disclosures here made. (See *Estate of Sisk*, 269 Cal. App.2d 823; *Stewart v. Flournoy*, 8 Cal.App.3d 449.)

"But what if Samuel had fulfilled the contract? No one would be the wiser. Herein lies the vice of enforcing the agreement.

"If this court were to put its imprimatur on this agreement under these circumstances, it would be an invitation to others to structure similar devices running only the risk of paying the taxes if the defect was discovered. Disclosure would be discouraged as well.

"The refusal of such judicial aid tends to reduce the number of such agreements and in this case lend a measure of stability to the rules which guide practitioners in the field of tax law. This is the goal we seek.

"Our conclusion is that this agreement is unenforceable as being against public policy." (Pet. for Cert. Append. B, pp. 28-29, 32-34).

II.

The California Supreme Court Considered and Decided a Substantial Federal Question.

In one breath respondent argues that the decision of the California Supreme Court was based on local law (Br. in Opp. p. 12); in the next, respondent argues that "[p]etitioners' primary contention that the agreement, because it tends to promote tax evasion, is against public policy, and hence is unenforceable, *has been vigorously argued before the California Supreme Court which fully considered the question. . . .*" (Br. in Opp. pp. 16-17; Emphasis added).

Clearly, the decision of the California Supreme Court rested on a determination that enforcement of the undisclosed oral agreement was not contrary to federal public policy and would not promote tax evasion. The reasoning of the Court is quoted in respondent's brief (p. 17). The argument that the California Supreme Court did not decide a substantial federal question is specious. This case is no different than one where, for example, a state court incorrectly holds that the federal constitution has not been violated. A state court may not escape from having determined a substantial federal question simply by holding that the constitution has not been abridged.

Petitioners respectfully submit that the California Supreme Court decided a substantial federal question since, as a condition precedent to enforcement of the oral agreement, the Court determined that its enforcement would not be contrary to federal public policy.

III.

The Marital Deduction Tax Benefit Is Unlawful Unless the Surviving Spouse Has the Unqualified Right to Give the Property to Whomever He Chooses.

Respondent incorrectly argues that the marital deduction is permissible even though the surviving spouse's power to appoint the property is severely limited. (Br. in Opp. p. 19). The law clearly is to the contrary. *Batterton v. U.S.*, 406 F.2d 247 (5th Cir. 1968); *Lindsay v. U.S.*, 167 F. Supp. 136 (D.C. Md. 1952); U.S. Treas. Estate Tax Reg. §2056(b)(5)(g)(2). Moreover, the California Supreme Court *and* the California Court of Appeal (although disagreeing about enforcement of the oral agreement) did agree that the marital deduction is lawful only if the surviving spouse is given the unrestricted power to dispose of the property as he chooses. (Pet. for Cert. Append. A. p. 5; Append. B. p. 28-29). The cases cited by respondent do not support the legal proposition which she asserts.

In *Dekker v. United States*, 245 F. Supp. 255 (D.C. S.D. Ill., 1965) (Br. in Opp. p. 20), the marital deduction was held proper because the spouses were *not* under contractual obligation to convey to a third party.

> ". . . *there is lacking here any indicia of the intent of Mr. and Mrs. Dekker in executing this will to effectuate a contractual disposition of property to their children*, thus limiting the interest of Mrs. Dekker, as the survivor of them, to a life interest only. . . . Clearly, the Dekkers intended a testamentary disposition of property to the survivor of them, *without restriction upon the survivor's title thereto*, with an alternative gift to children at the time when the survivor shall die." (at p. 257) (Emphasis added.)

In *First Nat'l. Bank of Janesville v. Nelson*, 355 F. 2d 546 (7th Cir. 1966) (Br. in Opp. p. 19), a husband and wife entered into an antenuptial agreement providing that the wife would accept one-third of her husband's estate or $100,000, whichever was smaller, and that upon her death she would bequeath the remainder to a specified individual. The husband predeceased the wife leaving her $100,000 by will *without any restriction on its disposition.* The Court of Appeals held the marital deduction proper because the husband removed all testamentary restrictions leaving the wife with full power to transfer the property to anyone. "We conclude there is nothing in the record before us to indicate that Mr. Craig intended to restrict the bequest to his wife with any of the limiting language found in the antenuptial agreement. The bequest to the Testator's wife specifically stated that it was 'exclusive of all charges' . . . *As the bequest to his widow was absolute,* the marital deduction should have been allowed." (at p. 548). (Emphasis added.)

Revenue Ruling 71-51 IRB 1971-5 (Br. in Opp. p. 20), is inapposite because it turns on the proposition that the surviving wife became absolute owner of the property by virtue of joint tenancy instruments and life insurance contracts, rather than receiving only a life estate under her husband's will. It does not and cannot modify or affect the clear language of the U.S. Treas. Estate Tax Regs. §2056(b)-5(g)(2) and §2056(c)-2(b)(5) which were applied in *Batterton v. United States*, *supra*.

IV.

Conclusion.

This Court is presented with a unique opportunity to preserve and protect the federal policies underlying the administration and enforcement of our tax laws. If this undisclosed oral agreement is enforced, it will invite tax evasion, which for the most part, will remain entirely undetected. Our taxing system rests upon honest and truthful reporting by taxpayers. The Internal Revenue Service is not equipped to detect all violations of law, especially those widespread unlawful practices which are based on oral agreements contrary to written instruments. Consequently, it is imperative that tendencies in this direction be discouraged.

Undisclosed side agreements, contrary to the tax laws, cannot be enforced if our system of taxation is to remain viable. Income and estate and gift tax benefits are available in many forms if legislative requirements are followed by taxpayers. If these requirements can be circumvented simply by entering into emasculating oral side agreements, the administration and enforcement of our tax laws will be severely crippled. At this critical juncture in our economic history, we can ill afford to lose legitimate tax revenues by encouraging taxpayers to claim unlawful tax benefits.

For these reasons, petitioners respectfully request that the petition for writ of certiorari be granted.

Respectfully submitted,

HERMAN F. SELVIN,
ALLAN BROWNE,
Attorneys for Petitioners.